

Service Date: September 28, 1994

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER OF the Application) UTILITY DIVISION
of GRANT CREEK WATER WORKS for)
Authority to Increase Rates and) DOCKET NO. 94.1.3
Charges for Water Service.) ORDER NO. 5773a

FINAL ORDER

APPEARANCES

FOR THE APPLICANT:

Edward Janecek, III, Datsopolous, MacDonald & Lind, 201 West
Main, Suite 201, Missoula, Montana 59802

FOR THE INTERVENORS:

Mary Wright, Staff Attorney, Montana Consumer Counsel, 34 West
Sixth Avenue, P.O. Box 201703, Helena, Montana 59620-1703

Timothy D. Geiszler, Attorney at Law, 265 West Front Street,
Missoula, Montana 59802, representing Grantland-Colorado Gulch
Association and Grantland Landowner's Association

FOR THE COMMISSION:

Denise Peterson, Staff Attorney, and Ron Woods, Rate Analyst,
1701 Prospect Avenue, P.O. Box 202601, Helena, Montana 59620-
2601

BEFORE:

BOB ROWE, Commissioner and Hearing Examiner

BACKGROUND

1. On January 6, 1994 Grant Creek Water Works (Applicant or Grant Creek) filed an application with the Montana Public Service Commission (Commission) for authority to increase water rates for its Missoula, Montana customers by approximately 233 percent, for an annual revenue increase of \$48,877.

2. Concurrent with this filing for a permanent increase in rates, Grant Creek filed an application for an interim increase in rates of 129 percent, for an annual revenue increase of \$27,000, or 55 percent of the requested permanent increase. The Commission took no action on Grant Creek's request for interim relief for lack of demonstrated need.

3. On May 3, 1994 the Commission held a properly noticed public hearing on the technical portion of the rate increase application, beginning at 10:00 a.m. in Room 500, Ruby's Reserve Street Inn, 4825 N. Reserve Street, Missoula, Montana, with an evening hearing beginning at 7:00 p.m. for the convenience of the public. At the conclusion of the hearing, the parties stipulated to a final order.

FINDINGS OF FACT

4. The Commission finds that the test year ending June 30, 1993, pursuant to the application, is a reasonable period to

measure the Applicant's utility revenues, expenses and returns to determine a fair and reasonable level of rates for water service. 5. At the public hearing the Applicant presented the testimony and Exhibits of:

Don Cox, Certified Public Accountant, Anderson, Zuermuehlen and Company,

Charles Johnson, Professional Engineer, Druyvestein, Johnson & Anderson, Consulting Engineers.

6. Grantland Landowner's Association (Association) presented the testimony and exhibits of:

Steve Savage, Operations Manager, Lambros Inc., Property Management,

Weymouth Symmes, Banker,

David Koerner, Accountant,

Bill Brunner, Director, Grantland Landowner's Association.

7. Montana Consumer Counsel (MCC) presented the expert testimony of Frank Buckley, its Rate Analyst, and also sponsored the testimony of five public witnesses.

8. The major contested issues follow:

- 1) Repairs and Maintenance Expense;
- 2) Legal/Trustee Expense;
- 3) Depreciation on Customer Contributed Assets;
- 4) Property Tax Expense;
- 5) Rate Basing of Proposed Chlorination Facility; and
- 6) Rate Design.

COST OF CAPITAL AND CAPITAL STRUCTURE

9. Grant Creek witness Cox proposed the following hypothetical capital structure and related costs, stating that the Commission had adopted similar capital structures in recent water rate proceedings:

| <u>Description</u> | <u>Ratio</u> | <u>Cost</u> | <u>Weighted Cost</u> |
|---------------------------------|---------------|-------------|--------------------------|
| Equity | 55.00% | 12.00% | 6.600% |
| Debt | <u>45.00%</u> | 12.00% | <u>5.400%</u> |
| | 100.00% | | |
| Composite Cost of Total Capital | | | 12.00% |

The capital structure was not challenged by any party. The Commission finds that the proposed capital structure is reasonable.

10. Grant Creek proposed a cost of debt, or interest, component which it alleged is the borrowing rate currently available to Grant Creek. Grant Creek relied upon a "Letter of Commitment" from the trustees of the Jack L. Green, II, irrevocable living trust to establish its currently available borrowing rate. This letter indicates that the trustees will lend up to \$50,000 to Grant Creek at a rate of 12 percent per annum.

11. The Association challenged the reasonableness of the assumed debt cost presented by Grant Creek. Its witness Symmes,

a Missoula Banker, testified that small water utilities could enter into commercial loan agreements of the size and duration outlined in the "Letter of Commitment" at a lower interest rate.

Mr. Symmes stated that, with appropriate collateral and cash flows, a small water utility could obtain a commercial loan at a rate of interest between 8 3/4 and 9 percent.

12. The Commission agrees with Mr. Symmes. Interest rates in the commercial debt market have been significantly lower than the cost proposed by the Applicant for this private placement. With the current opportunities in the commercial capital market, Grant Creek could potentially obtain debt at a cost lower than that proposed in its filing. The Commission finds that Grant Creek should be authorized a debt cost of 9 percent for purposes of calculating an overall rate of return.

13. Grant Creek proposed 12 percent as the cost of equity, which was the last authorized cost of equity allowed by the Commission in a water rate proceeding. See, In the Matter of the Application of Mountain Water Company, Docket No. 92.4.19, Order No. 5625b. Grant Creek's proposed cost of equity capital was not challenged by any participant in the proceeding. The market did not support this level of return on equity. However,

the Commission accepts the proposed cost of equity because of the minimal revenue requirement impact of \$34 per 100 basis points.

14. The Commission finds the following capital structure and composite cost of total capital to be reasonable:

| <u>Description</u> | <u>Ratio</u> | <u>Weighted Cost</u> | <u>Cost</u> |
|---------------------------------|---------------|----------------------|---------------|
| Equity | 55.00% | 12.00% | 6.600% |
| Debt | <u>45.00%</u> | 9.00% | <u>4.050%</u> |
| | 100.00% | | |
| Composite Cost of Total Capital | | | 10.650% |

Post-Test Year Plant Additions

15. In prefiled testimony Grant Creek testified that the Commission should deviate from generally accepted ratemaking principles and allow in rate base an estimated cost of \$34,500 for not yet constructed capital improvements.

16. MCC and the Association argued that utility property must be actually used and useful for the benefit of the public (Section 69-3-109, MCA) before the Commission can allow the costs in rate base. The Commission agrees that legally the Commission cannot include plant values in rate base unless the plant is actually used and useful in providing of service. Here, the Commission has no alternative but to deny Grant Creek's proposal to include not yet constructed plant in rate base.

17. The Applicant proposed financing the construction of the chlorination facilities using a private debt placement rather than a commercial institution. The debt cost agreed upon in the private placement is 12 percent. Testimony indicates that local commercial financial institutions may be willing to loan money to Grant Creek at a lower rate of interest. Before the Commission will accept the debt cost negotiated in the private placement as reasonable, Grant Creek must show that it is unable to obtain debt from commercial institutions at a more favorable rate.

18. The Commission recognizes that before a commercial financial institution will lend money to a small water utility, the utility must show that it will have the ability to repay the debt obligation. Section 69-3-109, MCA, requires that utility property must be used and useful before the Commission can assess the value of the investment for recovery of a return from the ratepayers. Grant Creek is under an order from the Montana Department of Health and Environmental Sciences to construct chlorination facilities. To minimize the constraint that the "used and useful" requirement may place on Grant Creek's ability to obtain financing, the Commission establishes the procedures outlined in the following findings.

19. At its discretion Grant Creek may file within 14 days of the service date of this Order a request to hold this Docket open for a revision to the filing upon completing construction and placing in service the facilities outlined in this filing. This order will be final and the Docket will be closed if the Commission does not receive notification within 14 days that Grant Creek wishes to continue this Docket.

20. The revised filing should include the actual costs incurred for the construction of the new facilities, a copy of the loan agreement entered into between the Applicant and the lender, and actual financial statements (Income Statement and Balance Sheet), closing within 30 days of the completed construction date. The Intervenors may review and file discovery and testimony, upon request for an expedited procedural schedule. The Commission will allow the Applicant to update its test year and, upon a proper showing, will recognize the reasonable costs associated with the newly constructed facilities deemed used and useful. The maximum revenue increase that the Commission may authorize in this Docket is limited by Grant Creek's original application, which provided for an annual revenue increase in the amount of \$48,877. For an increase in excess of that requested

in the original application, the Applicant may file another rate increase application.

RATE BASE

21. In its application Grant Creek proposed an original cost depreciated rate base of \$36,800. The Applicant's plant accounts, which represent a significant portion of the rate base, include the estimated cost of proposed capital improvements to the water system, totalling \$34,500. Grant Creek's proposed rate base was a contested issue in this proceeding.

22. MCC and the Association asserted that the Applicant's request to include these estimated costs in rate base should be denied. The Commission agrees and in preceding findings has stated its rationale for not allowing estimated costs.

23. The Applicant's Exhibit 1, Schedule 38.5.123, reflects a balance of \$60,297 for plant in service. This amount must be reduced by \$34,500 to reflect the Commission's finding that projected capital improvements are not used and useful and may not be included in rate base. The Commission finds that the plant in service during the test year is \$25,797.

24. Disallowance of the projected capital improvements in rate base requires a corollary adjustment to the "Accumulated

Depreciation Account," the accumulated depreciation associated with those assets. Accumulated depreciation on the proposed assets included in rate base is \$4,929. The Commission finds that the Applicant's accumulated depreciation for the test period should be reduced by \$4,929 to the level of \$21,240.

25. The Commission finds the Applicant's average original cost depreciated rate base to be \$6,207, calculated as follows:

| | |
|--------------------------|-----------------|
| Total Plant | \$ 25,797 |
| Cash Working Capital | 1,650 |
| Less: | |
| Accumulated Depreciation | <u>(21,240)</u> |
| TOTAL RATE BASE | \$ 6,207 |

OPERATING REVENUES

23. The Applicant used the actual fiscal year 1993 revenues for Grant Creek as test year revenue. The test period operating revenues of \$20,939 are not contested and are accepted by the Commission.

OPERATING EXPENSES

26. The Applicant proposed total test period operation and maintenance expenses of \$45,501, which include pro forma adjustments increasing expenses by \$30,700. MCC and the Association contested the proposed pro forma expense adjustments.

27. Grant Creek proposed a pro forma operating expense adjustment of \$3,700 to recover costs associated with the chlorinator. The Commission has disallowed Grant Creek's proposal to include chlorination facility costs in rate base, subject to revision upon completion of the facilities. Therefore, the Commission finds that Grant Creek's request to recover chlorinator operating costs should also be denied and the Applicant's pro forma operating expenses should be reduced by \$3,700.

28. In prefiled testimony Grant Creek witness Cox testified that historically repair and maintenance expense has been funded by the General Partner without recording those costs on the books and records of Grant Creek. He further testified that a pro forma expense adjustment of \$4,500 was warranted because these expenses are properly the responsibility of the utility and not the General Partner.

29. Grant Creek's response to data request MCC-8 shows that for the years 1991-1993 Grant Creek averaged \$1,533 in repair and maintenance expense. Based on the response to this data request both MCC and the Association recommended that the Commission disallow \$2,967 of the Applicant's proposed expense as unsubstantiated. The Commission agrees with the intervenors and finds Grant Creek's pro forma expenses should be decreased by \$2,967.

30. Grant Creek proposed including in pro forma expenses legal and trustee expenses of \$3,000. MCC and the Association argued that \$1,500 of these costs should be disallowed as non-recoverable from ratepayers because the costs represent expenses incurred, or to be incurred, in connection with the bankruptcy filing of Grant Creek. The intervenors asserted that the bankruptcy costs are the result of management inaction, confer no benefit to the customers and should be the responsibility of the equity investor. The Commission agrees with the intervenors and finds that the \$1,500 in bankruptcy related expenses should be disallowed.

31. The Commission finds the total annual operating expenses of the Applicant to be \$37,334.

DEPRECIATION EXPENSE

32. Grant Creek proposed total test period depreciation expense of \$9,846, including depreciation on proposed capital improvements and on contributed assets, which was contested by Intervenors. The disallowance of proposed capital improvements in the rate base requires an adjustment to the depreciation expense, reducing the annual depreciation expense. The ratepayers do not have the responsibility of reimbursing the equity

investor for plant determined not to be used and useful. The Commission finds that the Applicant's depreciation expense should be reduced by \$4,929.

33. Grant Creek requested that the Commission allow depreciation expense on the original water system owned and operated by Grant Creek. This system was constructed and financed with public funds supplied by owners of property in Grant Creek's service area. In regulatory terms, the assets acquired by the utility under these conditions are "contributed assets" because the utility has not dedicated or placed at risk any of its financial resources.

34. Grant Creek argued that it should be allowed to depreciate the contributed assets, because it will have to replace the assets at the end of their useful lives. A reasonable source of funding replacement, in Grant Creek's view, is depreciation expense. If allowed depreciation expense, Grant Creek indicated it would be able to accumulate the funds necessary to finance the replacements.

35. MCC and the Association objected to Grant Creek's proposal to depreciate contributed assets. Both parties argued that Grant Creek is not entitled to depreciation/replacement expense on assets provided through contribution. The Commission

agrees. Depreciation expense is allowed to a utility as a return of the original cost of its investment in utility plant.

Since Grant Creek has no investment in the contributed plant, it is not entitled to depreciation expense.

36. Grant Creek's argument that it should be allowed to depreciate contributed plant to accumulate the funds necessary to finance replacements is without merit. Under the regulatory compact, the private utility owner has the obligation to attract the capital (debt and equity) necessary to obtain capital items essential for the operation of the utility. Grant Creek's depreciation/replacement proposal would shift the burden of providing the necessary capital for replacement funding from the utility to the ratepayers. When Grant Creek started operations, it was aware that in time it would have to replace the facilities it received through donation. As a regulated utility Grant Creek should have known that it would have to obtain the capital necessary to do the replacement. The Commission denies Grant Creek's request to depreciate contributed assets and reduces its depreciation expense by \$4,677. The Commission finds that Grant Creek's total annual depreciation is \$240.

TAXES OTHER THAN INCOME

37. Grant Creek proposed a pro forma property tax expense of \$9,830, which includes an allowance of \$6,031 for current taxes and a ratemaking proposal to pay delinquent taxes, penalties and interest to be amortized over a 7 year period at a cost of \$3,799 annually.

38. The intervenors objected to Grant Creek's proposal to include recovery of delinquent property taxes, penalties and interest in rates. The intervenors argued that allowing recovery of delinquent taxes in current rates would violate the rule against retroactive ratemaking. If existing rates were not adequate to recover the (now delinquent) taxes, the intervenors maintained that the utility's management should have requested rate increases when the taxes were due.

39. Grant Creek countered the intervenors' argument by stating that it filed a rate increase application with this Commission in 1987 which was denied. Grant Creek claimed that if the Commission had granted the 1987 rate increase, it would have had funds to pay the delinquent property taxes in a timely manner. Grant Creek alleged that management acted prudently and timely filed for rate relief and that the Commission in denying rate relief caused the delinquency to occur.

40. The Commission finds that Grant Creek has flagrantly misrepresented the 1987 rate proceeding and the Commission's denial of Grant Creek's 1987 rate increase request. Further, Grant Creek is disingenuous in its allegation that the Commission is responsible for its tax delinquency. Grant Creek failed to ascertain its tax obligations as the notices allegedly accumulated in the wrong post office box. The following Findings of Fact from Commission Order No. 5308, Docket No. 87.2.10, issued November 24, 1987 on Grant Creek's 1987 rate increase request, provide the reasons for Commission denial of rate relief.

6. In this application Grant Creek has requested that the Commission authorize an increase in rates that will generate approximately \$1,080 in additional annual revenues. The Applicant's witness, Ms. Smith, stated that the increase in revenues sought in this application were needed to defray increased costs of operation and reduce the magnitude of operating losses currently being experienced by the Grant Creek.

7. During the course of this proceeding it was determined that the Applicant in its filing had not accounted for all revenues that should have been collected through rates. On November 1, 1985, Grant Creek filed with this Commission a request for authorization to implement a monthly fire hydrant rental charge for 6 and 8 inch fire hydrants. The Applicant proposed a monthly charge of \$18.88 and \$34.24 for 6 and 8 inch hydrants, respectively. On November 12, 1985 this Commission at its regularly scheduled

agenda meeting approved Grant Creek's request for implementation of the hydrant charges.

8. As of the date of the hearing in this Docket the Applicant had failed to make an assessment and collect the approved hydrant rental fees. If the Applicant had assessed and collected the hydrant rental fees authorized by the Commission, the Applicant would have generated, at a minimum, additional annual revenues amounting to approximately \$3,172. The Applicant's failure to collect these revenues is sufficient reason for the Commission to deny the Applicant's request for authorization to increase residential rates. The collection of revenues from the authorized hydrant rentals charges exceeds the revenue increase of \$1,080 requested in this filing. Since the revenue that would be generated by assessment of the approved hydrant rental fee exceeds the revenue request and those revenues have not been reflected in the Applicant's operating statements, the Commission finds that the Applicant's request for increased rates should be denied.

41. The record in Docket No. 87.2.10 supported the Commission's decision to deny Grant Creek's 1987 rate increase request. Management failed to collect the revenues it was entitled to collect, which would have covered its rate increase request in 1987. Never in that Docket did Grant Creek request recovery of tax expense. In fact, the tax delinquency for which it now requests recovery allegedly took it by surprise and occasioned the bankruptcy proceeding to obtain the benefit of the automatic stay. Grant Creek had the management duty to ascertain

its taxes, to pay these taxes on a timely basis and to request recovery of the tax expense as it came due, not many years later.

42. If the Commission allowed the request for recovery of prior period property tax expense from current customers, it would engage in illegal retroactive ratemaking. The Commission denies Grant Creek's request to recover \$3,799 in prior period property taxes and finds that Grant Creek's allowable property tax expense is \$6,031 accrued during the test year.

43. The Commission finds the following test period expenses appropriate for Grant Creek:

| | |
|------------------------------------|------------|
| Operation and Maintenance | \$ 37,334 |
| Depreciation | 240 |
| Taxes other than F.I.T | 6,173 |
| Federal Income Taxes | <u>-0-</u> |
| Total Operating Revenue Deductions | \$ 43,747 |

44. The Commission finds that Grant Creek sustains an operating loss in the amount of \$22,808, calculated as follows:

| | |
|----------------------|-----------------|
| Operating Revenue | \$ 20,939 |
| Operating Deductions | <u>(43,747)</u> |
| Operating Loss | \$(22,808) |

REVENUE REQUIREMENT

45. To produce a return of 10.650 percent on the Applicant's original cost depreciate rate base, the Applicant will

require additional annual revenue in the amount of \$23,469 from its Missoula, Montana water utility, as follows:

| | | |
|---------------------------------------|---------------|------------|
| Rate Base | \$ 6,207.00 | |
| Rate of Return | <u>10.65%</u> | |
| Return Requirement | | \$ 661 |
| Adjusted Balance Available for Return | | (22,808) |
| Revenue Deficiency | | (\$23,469) |

RATE DESIGN

46. Grant Creek provided testimony that the proposed rate structure is designed to generate total annual revenues of \$69,816 and represents an annual revenue increase totalling \$48,877. Grant Creek proposed to continue an unmetered rate assessment (monthly flat rate), a metered rate schedule and a fire hydrant rental charge. The proposed rate design, however, is significantly different than that currently on file with the Commission. The proposed flat rate design for single family dwellings uses billing determinants of number of bathrooms, bedrooms, baths, showers and toilets as the basis for determining the monthly flat rate. Grant Creek's proposed irrigation charge uses the billing determinant of irrigation square footage to determine the annual sprinkling fee.

47. The intervenors presented testimony and exhibits showing that Grant Creek's billing determinant information was inaccurate. The record in this proceeding establishes that Grant Creek's billing determinant information used to calculate flat and metered rate revenues, under the proposed rates, is incom-

plete and inaccurate. The Commission has no recourse but to reject the Applicant's proposed flat and metered rate design.

48. Grant Creek proposed increasing rates for public and private fire protection by 29 percent and 233 percent, respectively. Grant Creek's response to data request MCC-5 indicates that all hydrants on the system are 6 inch hydrants. Grant Creek did not prepare a detailed cost of service study. Without such a study the Commission cannot determine whether the disparate increase in hydrant rates is justified. The Commission rejects Grant Creek's proposal to increase fire hydrant rates by significantly different percentages when all hydrants are the same size.

49. On rejecting Grant Creek's proposed rate design, the Commission must specify a rate structure that will allow the Applicant the opportunity to generate the revenue requirement recognized in this order. The Commission finds that the Applicant should continue the water rate structure presently in effect and generate the authorized increased revenues by applying a uniform percentage increase to all rates and charges.

50. Grant Creek proposed a special rule of service to calculate the water usage of an irrigation customer. The customer subject to the application of this rule appeared and testified in

support of Grant Creek's proposal. The Commission approves the following rule as proposed:

Metered rates will apply to water provided through a water meter. In instances where a customer is supplied by a line larger than 3/4" and where all water provided by the utility to the customer is then pumped by the customer prior to the customer's use of the water, the water usage may be estimated based upon pump capacity and electricity usage by the customer pumps or through use of an hour meter on the pump.

RESIDENTIAL METERING

51. Public testimony supported metering to provide fair and accurate prices and avoid speculative nature of various other billing options. The public also offered suggestions on how to address the cost of meter installation and reading. Some of the public opposed metering on the basis of the possible cost. The Commission finds that the Landowners' Association and some individual ratepayers are informed utility customers committed to improving their water system.

52. Applicant is directed to meet with the Association and interested ratepayers to discuss issues relating to metering, including the following:

- (1) Is metering in the best interests of the parties?

- (2) If so, how should a metering program be instituted and paid for?
- (3) How should metering be conducted to ensure both reliability and minimal costs?

The Parties should present the results of their efforts to the Commission no later than February 1, 1995. At that time, Parties may request formal or informal action from the Commission.

CONCLUSIONS OF LAW

1. The Applicant, Grant Creek Water Works, is a public utility as defined in ' 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over the utility's rates and service pursuant to ' 69-3-102, et seq., MCA.
2. The Commission has provided adequate public notice and an opportunity to be heard as required by ' 69-3-303, MCA, and Title 2, Chapter 4, MCA.
3. The rates and rate structure approved in this order are just and reasonable. ' ' 69-3-201 and 69-3-330, MCA.

ORDER

NOW THEREFORE, IT IS ORDERED THAT:

1. Grant Creek Water Works shall file rate schedules which reflect an increase in annual revenues of \$23,469 for its Missoula, Montana service area. The increased revenues shall be generated by increasing rates and charges as provided herein.

2. The rates shall become effective upon service of this Order.

3. The Applicant is authorized to implement rule changes as provided in this Order.

4. The Applicant shall comply with the provisions in this order, including those for metering and revised filing.

Done and Dated this 27th day of September, 1994 by a vote 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BOB ANDERSON, Chairman

BOB ROWE, Vice Chairman

DAVE FISHER, Commissioner

NANCY MCCAFFREE, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Kathy Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.